

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 02-01**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of Tennessee sales and use tax to a maker of [FABRICATED PRODUCTS], when a customer cancels an order and the [FABRICATED PRODUCT] has already been made.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling, and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] makes [FABRICATED PRODUCTS] in the course of its business. The taxpayer has several plants for this purpose in various states, including in Tennessee. The general corporate offices of the taxpayer are also located in Tennessee. The taxpayer states that a majority of its sales are exempt from Tennessee tax because title to and possession of the manufactured products are delivered to the customer out-of-state. The tax treatment of these sales is not at issue in this ruling.

When the taxpayer receives a request to make a [FABRICATED PRODUCT], it obtains a deposit from the customer. In some instances, the customer cancels the order or fails to take delivery after the [FABRICATED PRODUCT] has been made. When this happens, the customer forfeits the deposit.

The taxpayer then has to dispose of the unused [FABRICATED PRODUCT], which has no value. The cost of the materials for these unused [FABRICATED PRODUCTS] may or may not be covered by the deposit. Materials used in the creation of [FABRICATED PRODUCTS] and incorporated into them are purchased free of sales tax on a valid resale certificate. Materials that can be salvaged for later use are returned to inventory.

QUESTIONS

1. Does Tennessee sales tax apply when the taxpayer retains a deposit because a customer cancels the order or fails to take delivery of the [FABRICATED PRODUCT], as described in the facts provided?
2. Does Tennessee use tax apply to the materials consumed in the creation of [FABRICATED PRODUCTS] for customers who cancel the order or do not take delivery of the product, as described in the facts provided?

RULINGS

1. No. Tennessee sales tax does not apply to the deposit retained by the taxpayer, because the payment was not for a taxable sale under the facts provided.
2. Yes. The Tennessee use tax is levied on the cost price of the tangible personal property that is discarded as described in the facts provided.

ANALYSIS

1. Tennessee law levies a tax on the sale of tangible personal property at retail in this State. T.C.A. § 67-6-202. A sale consists of the transfer of title or possession, or both, of tangible personal property for a consideration. T.C.A. § 67-6-102(25)(A); *Volunteer Val-Pak v. Celauro*, 767 S.W.2d 635, 636 (Tenn. 1989). Under the facts provided, neither title to nor possession of the [FABRICATED PRODUCT] ever passes to the customer. Therefore, there is no taxable sale in Tennessee, and Tennessee sales tax is not due.

2. Tennessee law levies a tax on the cost price of tangible personal property that is "... used, consumed, distributed, or stored for use or consumption in this state; provided, that there shall be no duplication of the tax." Tenn. Code Ann. § 67-6-203(a). Tennessee law defines "cost price" as "... the actual cost of articles of tangible personal property without any deductions therefrom on account of the cost of materials used, labor, or service costs, transportation charges, or any expenses whatsoever[.]" Tenn. Code Ann. § 67-6-102(6). The statutory definition of "use" includes "... the exercise of any right or power over tangible personal property incident to the ownership thereof, except that it does not include the sale at retail of that property in the regular course of business." Tenn. Code Ann. § 67-6-102(31)(A).

Clearly, the discarding of tangible personal property falls within the statutory definition of "use." One does not discard tangible personal property that one does not own. Discarding is the exercise of a right or power over tangible personal property incident to ownership. Thus, according to Tennessee law, the Tennessee use tax applies to the discarding of tangible personal property in the course of business.

Furthermore, in those specific instances in which the taxpayer installs a [FABRICATED PRODUCT] as an improvement to real property (as opposed to selling the [FABRICATED PRODUCT] as tangible personal property), the taxpayer is the user and consumer of the [FABRICATED PRODUCT]. Likewise, the taxpayer is the user and consumer of the materials that are used in the production of the [FABRICATED PRODUCT]. In these instances, the taxpayer is the user and consumer of the materials that ultimately are discarded.

Contractors engaged in constructing or improving real property, whether on a lump sum or a cost-plus basis, are purchasers and consumers of the materials used by them, and are required to pay the Sales or Use Tax on such materials or equipment purchased or imported into this State for use in connection with their contracts. Tenn. Comp. R. & Regs. 1320-5-1-.07(1).

There is no provision in Tennessee law for any refund or credit to consumers of tangible personal property who ultimately discard some or all of the tangible personal property. For example, if a consumer of milk purchases a gallon of milk at the grocery store and pays the Tennessee sales tax on it, the consumer cannot claim a refund or credit for any amount of tax paid on milk that is spilled or becomes spoiled. The loss for discarding the tangible personal property falls entirely on the consumer. Therefore, in the specific instances in which the taxpayer is the user and consumer of the discarded materials, there is an additional reason why the Tennessee use tax applies to the cost price of the tangible personal property.

For the reasons explained above, the Tennessee use tax would apply to the scrapped materials that were purchased originally on a resale certificate. The tax base would be the cost price of the tangible personal property that the taxpayer scraps.

Steve Butler
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APPROVED: Ruth E. Johnson
Commissioner

DATE: February 12, 2002